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No. 99-579

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IN THE

# Supreme Court of the United States

HARRIS TRUST AND SAVINGS BANK, not individually but solely as Trustee for the Ameritech Pension Trust, and AMERITECH CORPORATION,

*Petitioners*,

v.

SALOMON SMITH BARNEY INC. and SALOMON BROTHERS REALTY CORP.,

*Respondents.*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

## REPLY BRIEF FOR THE PETITIONERS


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## REPLY BRIEF FOR THE PETITIONERS

The parties agree that analysis in this case of statutory construction "begins with the language of" ERISA. Resp. Br. 11 (quoting *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 438 (1999)). The parties also agree that the Court should be "reluctant to tamper with an enforcement scheme crafted with such evident care as the one in ERISA." Resp Br. 34 (quoting *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 147 (1985)). These interpretive principles favor Petitioners, not Respondents. Petitioners' interpretation accounts for *all* the relevant statutory language. Respondents' interpretation, in contrast, requires the Court to "tamper with" ERISA's carefully-crafted enforcement scheme. Interpreting ERISA § 502(a)(3) to allow suits for equitable restitution – the return of plan assets and profits – from non-fiduciary parties in interest who engage in prohibited transactions with a plan "is consistent with" – indeed, required by – "the literal language of the statute, the Act's purposes, and pre-existing trust law." *Varity Corp. v. Howe*, 516 U.S. 489, 515 (1996).

### I. The Statutory Text Authorizes Civil Actions Seeking Restitution From Parties In Interest That Engage In Prohibited Transactions With A Plan.

1. **Section 502(a)(3).** Respondents and their *amici* assert that § 502(a)(3) only authorizes "plaintiffs to seek 'appropriate equitable relief' against *violators* of provisions that appear elsewhere in Title I." Resp. Br. 15; *see* ACLI Br. 8; BMA Br. 25. That assertion is essential to Respondents' argument. Unfortunately for Respondents, it is not faithful to the carefully-crafted language of § 502(a)(3). If Congress had wanted to restrict § 502(a)(3) to "violators," it would have used different language to achieve that result – for example, by authorizing a cause of action against "any fiduciary" or "any person" who violates a provision of Title I.[1] The statutory language that Congress used in

[1] Congress used just such language in a subsequent statute modeled directly on ERISA. *See* Federal Employees' Retirement System Act of 1986, Pub. L. No. 99-335, 100 Stat. 514 (codified as amended at 5 U.S.C. § 8477). That statute provides: "[A] civil action may be brought ... by the (...footnote continued)

§ 502(a)(3) is quite different. Without restricting the parties subject to suit, Congress authorized civil actions for "appropriate equitable relief" to "redress" "any act or practice which violates any provision of" Title I of ERISA. As explained in Petitioners' opening brief (Pet. Br. 15-18), the reference to "any act or practice which violates" Title I, rather than "any person who violates Title I," dovetails with the reference to "appropriate equitable relief" to "redress" such violations. *See also* U.S. Br. 14 ("Redress" means "the setting right of what is wrong."). "[A]ppropriate equitable relief" includes equitable restitution pursuant to a constructive trust, which is *not* limited to "violators," but extends to any party who has been unjustly enriched as a result of a *violation*, where restitution would "redress" the violation. *See* Pet. Br. 28-31; *Beatty v. Guggenheim Exploration Co.*, 122 N.E. 378, 380-81 (N.Y. 1919) (Cardozo, J.) ("A constructive trust is the formula through which the conscience of equity finds expression. When property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee."). In short, Congress's carefully-crafted statutory language focuses on *violations*, not *violators*.[2]

Petitioners are not asking this Court to "infer" a cause of action that Congress did not "incorporate expressly" into ERISA's civil enforcement provisions. *Russell*, 473 U.S. at 146-47. To the contrary, Petitioners ask the Court to interpret those provisions according to their plain terms. It is *Respondents* who must ask the Court to "tamper with" carefully-crafted statutory language.

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(. . . continued)
Secretary of Labor [or] ... any participant, beneficiary, or fiduciary *against any fiduciary* ... to enjoin any act or practice which violates any provision of subsection (b) or (c) [or] to obtain any other appropriate equitable relief to redress a violation of any such provision." 5 U.S.C. § 8477(e)(3)(A), (B) (emphasis added).

[2] Other subsections of § 502 confirm that Congress's choice not to limit the parties subject to suit under § 502(a)(3) was deliberate. For example, § 502(a)(2) refers to § 409 and thereby authorizes suits *only* against fiduciaries.



2. **Section 406(a) and Related Provisions.** Section 406(a) prohibits certain "[t]ransactions between [a] plan and [a] party in interest." 29 U.S.C. § 1106(a). Respondents focus on the introductory clause, which states that a "fiduciary ... shall not cause" a plan to engage in such a transaction. Because § 406(a) does not contain a similar express direction that parties in interest shall not engage in such transactions, Respondents contend, § 406(a) does not prohibit non-fiduciary parties in interest from engaging in any transactions with a plan. That is precisely the "'blue pencil' method of statutory interpretation" this Court has rejected. *Russell*, 473 U.S. at 142; *see also FDA v. Brown & Williamson Tobacco Corp.*, No. 98-1152, slip op. 9 (Mar. 21, 2000) ("[A] reviewing court should not confine itself to examining a particular statutory provision in isolation. ... A court must ... 'fit, if possible, all parts into an harmonious whole.'") (citations omitted). When *all* the relevant parts of ERISA are considered, it is clear that § 406(a) prohibits *transactions* (not just fiduciary conduct) and that a party in interest violates § 406(a) by engaging in a prohibited transaction.[3]

a. **Section 3003(c).** ERISA § 3003(c) directs the Secretary of Labor to transmit to the Secretary of the Treasury any "information indicating that *a party-in-interest* or disqualified person *is violating section 406* of this Act." (Emphasis added). The text of

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[3] Section 406(a) provides that a fiduciary shall not cause a plan to engage in a transaction if "he knows or should know" that the transaction is prohibited. Respondents assert (Resp. Br. 7) that the absence of similar language with respect to parties in interest makes sense only if § 406(a) is directed solely to fiduciaries. Not so. A party in interest who engages in a transaction prohibited by § 406(a) is subject to punitive excise taxes (26 U.S.C. § 4975) or civil penalties (§ 502(i)) *without regard to what the party in interest knows or should know*. In contrast, a party in interest generally is subject to equitable restitution pursuant to § 502(a)(3) only if it is not a "bona fide purchaser for value," *i.e.*, a purchaser who neither knew nor should have known that the transaction was prohibited. *See infra* pages 8-9 n.9, 10-11. The "knows or should know" language in § 406 serves the important purpose of subjecting a fiduciary (but not a non-fiduciary party in interest) to personal liability for direct and consequential *damages* arising from the transaction. *See* ERISA § 409.

§ 3003(c) thus gives a clear answer to the question whether a "party in interest" can "violat[e]" § 406(a): It can. Respondents' effort to explain away § 3003(c) borders on the absurd. Respondents assert (Resp. Br. 24-25) that, although Congress *said* "party-in-interest," it *meant* "fiduciary." But "party in interest" and "disqualified person" are defined terms, *see* ERISA § 3(14); 26 U.S.C. § 4975(e)(2); and both terms are considerably broader than "fiduciary," which is also statutorily defined, *see* ERISA § 3(21), 26 U.S.C. § 4975(e)(3). Moreover, § 3003(c) plainly is intended to cover all persons who may be subject to an excise tax. The tax applies to "*any* disqualified person *other than* a fiduciary acting only as such" (*i.e.*, a fiduciary who merely causes a plan to engage in a prohibited transaction with a party in interest). *See* 26 U.S.C. § 4975(a), (b) (emphasis added).

b. **Section 502(*l*).** Section 502(*l*) provides that a fiduciary "or other person" may be ordered to pay money "to a plan or its participants and beneficiaries in a judicial proceeding instituted by the Secretary under subsection ... (a)(5)" (and, therefore, in a judicial proceeding under subsection (a)(3)). The text of § 502(*l*)(4) confirms that "other person" refers to a non-fiduciary party in interest who engages in a prohibited transaction by expressly referencing the "penalty or tax imposed on such ... other person ... under subsection (i) of this section and section 4975." Respondents' cursory discussion of § 502(*l*) (Resp. Br. 23) mirrors their handling of § 3003(c): although Congress *said* "fiduciary or other person," it *meant* "fiduciary or co-fiduciary." But a co-fiduciary *is* a "fiduciary." Moreover, "person" is a defined term in ERISA, and means something very different from "fiduciary." *Compare* ERISA § 3(9) *with* ERISA § 3(21).[4]

c. **Section 4975(h).** Rather than recognizing 26 U.S.C. § 4975(h) for what it is – a provision that explicitly recognizes the

[4] Respondents incorrectly suggest (Resp. Br. 23) that § 502(*l*) has no bearing on the interpretation of § 406(a) because § 502(*l*) was added to ERISA in 1989. Section 502(*l*) is an integral part of ERISA; the Court's obligation to fit the statutory parts into "an harmonious whole" applies as much to § 502(*l*) as to any other provision of the statute.



Secretary of Labor's authority to "obtain a correction of the prohibited transaction" – Respondents contend (Resp. Br. 24) that the Secretary of Labor's authority extends only to cases in which the party in interest happens to be a fiduciary. In all other cases, according to Respondents, the Secretary of Labor is limited to "threat[ening] that the *IRS* will assess a tax or "comment[ing]" on the situation. *Id.* It is unlikely that Congress would assign one agency the tasks of merely commenting on another agency's work or threatening action that only the other agency is authorized to take. Any such threat could be made more credibly, and with less bureaucratic paper-shuffling, by the IRS itself.[5]

d. **Section 502(i).** By imposing substantial penalties on parties in interest who engage in prohibited transactions, § 502(i), together with § 4975, demonstrates that parties in interest are in fact prohibited from engaging in such transactions. As the district court recognized, if § 406(a) does not apply to parties in interest, then Congress had no basis for penalizing parties in interest who engage in transactions prohibited by § 406(a). J.A. 304.

Contrary to the court of appeals' reasoning (J.A. 350), the presence of civil penalties under § 502(i) and punitive taxes under § 4975(h) does not make the absence of a "specific" provision imposing civil liability on parties in interest "striking." In *Varity*, the Court found no reason to "believe that Congress intended ... specific remedies" in § 409 "as a *limitation*" on general remedies under § 502(a)(3). *Varity*, 516 U.S. at 511. The same is true here. Section 502(a)(3)'s language creating a civil cause of action for

[5] The statutory text refutes the assertion (ACLI Br. 27) that the IRS has "sole enforcement authority" with respect to non-fiduciary parties in interest that engage in prohibited transactions with tax-qualified plans. Section 4975(h) expressly gives the Secretary of Labor a role in enforcing the prohibited transaction provisions against parties in interest. Section 3003(b)'s requirement that Labor and the IRS "consult" and "coordinate" hardly suggests a sharp division of authority between the agencies. And contrary to ACLI's representation (ACLI Br. 28), the "notification dut[ies]" of Labor and the IRS *are* "reciprocal": Section 3003 requires Labor to notify the IRS, while § 4975(h) (which is expressly referenced in § 3003) requires the IRS to notify Labor.

"appropriate equitable relief" to "redress" "any act or practice which violates" Title I is clear, broad, and unqualified. The Court should decline Respondents' invitation to re-write the statute.[6]

e. **Section 206(e).** Respondents point to § 206(e) as "[a]nother" provision that is "directed against only one party to a transaction." Resp. Br. 7-8. According to Respondents, the language of § 206(e) (a "fiduciary ... shall not permit" a plan to make a "prohibited payment" to a participant or beneficiary) implies that § 206(e) applies solely to fiduciaries. Respondents' reliance on § 206(e) begs the question whether a participant or beneficiary who receives a payment of plan assets to which he or she is not entitled, in violation of ERISA, may be required to return the assets pursuant to § 502(a)(3). The unambiguous text of § 502(a)(3) compels an affirmative answer to that question.[7]

In sum, Respondents' interpretation of § 406(a) fails to "fit ... all parts [of the statute] into an harmonious whole." *Brown & Williamson*, No. 98-1152, slip op. 9. When all the relevant statutory provisions are considered, it is clear that the prohibited transaction provisions of § 406(a) apply to non-fiduciary parties in interest as well as to fiduciaries.[8]

[6] ACLI incorrectly asserts (ACLI Br. 16 n.7) that ERISA's statute of limitations, § 413, applies only to claims against fiduciaries, and thus leaves non-fiduciary parties in interest facing "open-ended potential liability." Section 413 establishes a limitations period for suits "with respect to a fiduciary's breach of any responsibility, duty, or obligation under this part, *or with respect to a violation of this part* ...." (Emphasis added).

[7] If actions for equitable restitution under § 502(a)(3) were limited to "violators" there would be no way to recover plan assets paid out in violation of § 206(e) – a result Congress is unlikely to have intended. Respondents' other examples of transactions prohibited "on one side only" are inapposite. It is hardly surprising, for instance, that Congress would choose to impose civil liability on an investment advisor for defrauding his client, rather than on the client for *being defrauded*, *see* 15 U.S.C. § 80b-6; or on a U.S. citizen for selling arms to a terrorist-sponsoring nation rather than on a foreign sovereign for purchasing the arms, *see* 22 U.S.C. § 2780(b).



## II. A Non-Fiduciary Party In Interest Has A Duty Under ERISA To Return Assets Obtained In A Prohibited Transaction With A Plan.

1. Respondents assert (Resp. Br. 13, 16-19) that ERISA does not impose any duties or liabilities on non-fiduciary parties in interest and, therefore, that there is no basis for subjecting them to actions for equitable restitution under § 502(a)(3). For the reasons explained in Part I above, § 406(a) imposes on non-fiduciary parties in interest a duty to refrain from engaging in prohibited transactions. *See also* Pet. Br. 15-27. Moreover, it is undisputed that non-fiduciary parties in interest are subject to significant liabilities, in the form of punitive excise taxes (26 U.S.C. § 4975) or civil penalties (§ 502(i)), that are designed to (1) deter parties in interest from engaging in prohibited transactions, (2) encourage parties in interest who engage in such transactions to correct them, and (3) deprive parties in interest who refuse to correct a prohibited transaction of all plan assets acquired in the transaction. Congress was not silent or ambivalent about the duties or liabilities of non-fiduciary parties in interest: ERISA treats parties in interest who engage in prohibited transactions as wrongdoers subject to punitive sanctions.

2. Moreover, non-fiduciary parties in interest have a duty to undo prohibited transactions under § 502(a)(3). Respondents resist this conclusion, but it follows directly from the language of

[8] Because the statutory language is unambiguous, that "is the end of the matter." *Chevron U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837, 842 (1984). If that were not so, however, it would be appropriate to defer to the Secretary of Labor's interpretation of § 502(a)(3) and (a)(5). Respondents' reliance on *Adams Fruit Co v. Barrett*, 494 U.S. 638 (1990), is misplaced. There, Congress had established an "enforcement scheme" wholly "independent of the Executive." *Id.* at 650. Where, as here, Congress has created a dual enforcement scheme, deference is appropriate. *Cf. NAACP v. American Family Mut. Ins. Co.*, 978 F.2d 287, 300 (7th Cir. 1992). Deference under *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944), is appropriate in any event.

§ 502(a)(3). Even if Respondents were correct that the only person who can violate § 406(a) is the fiduciary who causes a plan to enter into a prohibited transaction, the transaction itself (or, at least, the fiduciary's act of causing the plan to enter into the transaction) is undeniably an "act or practice which violates" § 406(a). Restitution pursuant to a constructive trust is clearly "appropriate equitable relief" to "redress" such a violation under § 502(a)(3), even if the party in interest did not itself violate § 406(a).

a. Respondents invoke this Court's statement that, "because ERISA is a comprehensive and reticulated statute ... it should not be supplemented by extra-textual remedies." Resp. Br. 16 (quoting *Hughes Aircraft*, 525 U.S. at 447). That statement does not apply to this case, because the remedy Petitioners are seeking is *not* "extra-textual." The text of § 502(a)(3) expressly provides for "appropriate equitable relief," thereby explicitly referring to and incorporating common law principles governing equitable remedies. The relevant interpretive principle is thus not that the Court should avoid "extra-textual remedies," but that where Congress expressly employs "the language and terminology of trust law," it is appropriate to look to judicially-developed "principles of trust law" to interpret the statutory language. *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 110-11 (1989); *Varity Corp.*, 516 U.S. at 496.

b. Respondents deny (Resp. Br. 16) that ERISA's explicit authorization of "appropriate equitable relief" to "redress" "any act or practice which violates" Title I refers to "any supposed doctrine imposing liability upon nonviolators." Respondents cite no authority for this assertion – and with good reason. It is settled beyond dispute that the equitable remedy of restitution pursuant to a constructive trust does *not* turn on whether the defendant is a "violator" or wrongdoer, but instead depends on whether the defendant would be unjustly enriched if allowed to retain trust assets. *See* Pet. Br. 28-31 (citing authorities).[9] Under equitable

[9] Respondents' suggestion (Resp. Br. 18) that a transferee of trust property must have "actual knowledge" of a breach in order to be subject to restitution pursuant to a constructive trust is incorrect and misleading. The section of Scott's treatise that Respondents cite (which discusses

(...footnote continued)



principles expressly incorporated into ERISA by § 502(a)(3), restitution pursuant to a constructive trust is thus "appropriate" to "redress" a violation of ERISA, without regard to whether the party in possession of the assets is itself a "violator."[10]

c. Respondents next accuse Petitioners of advocating a "hybrid" cause of action" that looks to Title I of ERISA to determine whether there has been a violation and to the common law to determine the nature and scope of "appropriate equitable relief." Resp. Br. 18. This so-called "hybrid" is not the result of tricky lawyering; it is what the statutory language commands. Under § 502(a)(3), in the event of "any act or practice which violates any provision of" Title I, designated plaintiffs are authorized to bring a civil action for "appropriate equitable relief" to "redress" the violation. The statutory language thus directs courts to look to the statute to determine whether there is a substantive violation, and to

(. . . continued)

participation-in-fiduciary-breach claims, not claims against a transferee of trust property) observes that actual knowledge is a *sufficient* (but not a *necessary*) basis for imposing a constructive trust; the authors repeatedly recognize that constructive knowledge is also sufficient. *See* IV Austin W. Scott & William F. Fratcher, *The Law of Trusts* § 326.1, at 293-95 (4th ed. 1989) ("reason to know," "should have known," "reason to believe"). Contrary to Respondents' assertion (Resp. Br. 18), *all* of "Ameritech's authorities" – and many more – confirm that constructive knowledge is a sufficient basis for holding a transferee liable for the return of trust property. *See, e.g., Restatement of Restitution* § 174 (1937) ("should know"); *Restatement (Second) of Trusts* § 297(a) & cmt. a (1959) ("should know"); IV Scott & Fratcher, *supra*, § 297, at 110 ("should know"); George G. Bogert & George T. Bogert, *The Law of Trusts and Trustees* § 891, at 265 (2d ed. 1995) ("should have possessed").

[10] The legislative history specifically confirms that "appropriate equitable relief" includes a "constructive trust ... imposed on the plan assets." S. Rep. No. 93-383, at 105 (1973), 1 Leg. Hist. 1173. Respondents would have the Court ignore this clear statement for the sole reason that the Senate bill to which it refers was not ultimately enacted *in toto*. As shown below, however, *see infra* page 16, § 502(a)(3)'s reference to "appropriate equitable relief" was modeled on the language of the Senate bill.

common law principles to determine the nature and scope of "appropriate equitable relief" to "redress" the violation.

It is hardly surprising that Congress, given its goal of providing additional protection for plan assets, *see, e.g., Boggs v. Boggs*, 520 U.S. 833, 845 (1997), would modify the substantive rules governing transactions with a plan (which Congress found to be inadequate), while incorporating judicially-developed principles governing appropriate equitable relief for substantive violations (which Congress did not find to be insufficient). Congress thus *displaced* the common law rules governing the conduct of fiduciaries and others who deal with plans (§ 406(a)), but *embraced* common law rules governing the nature and scope of "appropriate equitable relief" (§ 502(a)(3)). Whether dubbed a "hybrid" or not, that is the outcome required by the statutory text and this Court's precedents considering the interaction of ERISA and the common law.[11]

d. Respondents incorrectly assert (Resp. Br. 18) that Petitioners are seeking to impose "strict liability" on non-fiduciary parties in interest under § 502(a)(3). To be sure, *Congress* imposed "strict liability" on parties in interest under 26 U.S.C. § 4975 and ERISA § 502(i), both of which impose liabilities without regard to what the party in interest knew or should have known. Liability for equitable restitution under § 502(a)(3) is significantly *more* protective of parties in interest. As Petitioners have explained, Pet. Br. 30 n.15 (and as Respondents ultimately acknowledge, Resp. Br. 19), the law of equitable restitution contains built-in limitations that protect parties in interest. Specifically, equitable restitution pursuant to a constructive trust is generally available only if the party in interest (1) did not pay for

[11] Respondents' detour into the question whether, at common law, a trustee violated his fiduciary duty by causing a trust to enter into a transaction with a service provider (Resp. Br. 17) is thus a red herring. To the extent that common law rules are inconsistent with ERISA – as they plainly are under § 406(a) – they are irrelevant to the Court's inquiry. *See Varity*, 516 U.S. at 497.



the plan assets *or* (2) knew or should have known that the transaction was prohibited.[12]

## III. Interpreting ERISA In Accordance With Its Text Furthers The Principal Purpose Of The Statute.

1. As in *Varity*, "ERISA's basic purposes favor a reading of [the statute] that provides the plaintiffs with a remedy." 516 U.S. at 513. The "principal object" of ERISA "is to protect plan participants and beneficiaries." *Boggs*, 520 U.S. at 845. One of the principal means Congress adopted to achieve this object was "to bar categorically" prohibited transactions that Congress viewed as "likely to injure the pension plan." *Commissioner v. Keystone Consol. Indus., Inc.*, 508 U.S. 152, 160 (1993). Congress "provide[d] both the Secretary and participants and beneficiaries with broad remedies for redressing or preventing violations of [ERISA]." *Varity*, 516 U.S. at 512. By seeking to allow parties in interest to keep plan assets obtained in transactions that Congress

[12] Respondents err in asserting (Resp. Br. 19-22) that Petitioners have waived any argument that is not premised on a "direct" violation of § 406(a) by a non-fiduciary party in interest. Respondents do not dispute that the Question Presented in the Petition (like the question certified to the court of appeals) fairly includes the question whether a party in interest who engages in a prohibited transaction can be sued under § 502(a)(3) because the transaction is an "act or practice which violates" § 406(a), and restitution is "appropriate equitable relief" to "redress" the violation. *See* Pet. Reply Br. 3 n.2. "Once a federal claim is properly presented, a party can make any argument in support of that claim; parties are not limited to the precise arguments they made below." *Yee v. City of Escondido*, 503 U.S. 519, 534-35 (1992). Moreover, Count II of Petitioners' Complaint is not "the sole count before this Court." Resp. Br. 5. Under 28 U.S.C. § 1292(b), an appellate court may address "any issue fairly included within the certified order." *Yamaha Motor Corp. v. Calhoun*, 516 U.S. 199, 205 (1996). The certified order in this case dismissed Count III (and Count II to the extent it is "premised on an alleged breach of fiduciary duty"). J.A. 324. In any event, Respondents place too much weight on a sentence fragment from Petitioners' brief in the court of appeals *See* Resp. Br. 21. The full sentence clarifies Petitioners' position: "Because [§ 502(a)(3)] unambiguously authorizes suits to redress ERISA violations, Salomon's argument ... depends entirely on the meaning of [§ 406(a)]." Pet. C.A. Br. 18.

intended to "bar categorically," Respondents would undermine ERISA's principal purpose.

2. As Petitioners' opening brief explains (Pet. Br. 33-39), ERISA's excise tax and civil penalty provisions are not adequate to prevent or redress all prohibited transactions. Respondents deny (Resp. Br. 39) that Petitioners have submitted any evidence of "an enforcement gap." Not so. Petitioners, Respondents' *amici*, and even Respondents' own *counsel,* have referred to data showing that total receipts from the first-tier excise tax are minuscule compared to the nearly $5 trillion in assets in nearly 700,000 tax-qualified pension plans in the U.S.[13] Moreover, a congressional committee has concluded that, as plan assets have multiplied and the number of plans has increased, "the Department of Labor has become increasingly less able to fulfill its responsibility to detect and deter abuse of plan assets." H.R. Conf. Rep. No. 101-386, at 432 (1989).[14] As the Solicitor General recognizes (U.S. Br. 2), "[b]ecause of the 'enormity of the task' of enforcing the guarantees of ERISA, private civil actions under § 502(a)(3) are a necessary complement to actions by the Secretary." The idea that government enforcement alone is sufficient is wishful thinking.

3. Respondents and their *amici* predict that various dire results will ensue unless the court of appeals' decision is affirmed. *See*, *e.g.*, BMA Br. 8-12 (forecasting disruption of the established business practices of financial institutions, increased costs of administering plans, decreased investment opportunities, and harm to U.S. capital markets). If these Chicken-Little statements were true,

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[13] *See* Pet. Br. 36 n.20; BMA Br. 11; Peter C. Hein, *Excise Tax Enforcement Under Code Section 4975*, *in* Pension Plan Investments: Confronting Today's Investment Issues, at 877, 892 (PLI 1997) ("[V]ery modest revenues are realized (and are expected in the future) from the § 4975(a) tax.").

[14] The Pension and Welfare Benefits Administration has "fewer than 400 investigators" to investigate "civil and criminal violations relating to employee benefit plans.... For this reason, a 1995 report by the Brookings Institution referred to PWBA as *probably the most highly leveraged agency in the U.S. Government*." 65 Fed. Reg. 18,208 (Apr. 6, 2000) (emphasis added; citation omitted).



the sky would have fallen long ago. Non-fiduciary parties in interest are clearly subject to punitive excise taxes or civil penalties for engaging in prohibited transactions. Moreover, the law in *every* circuit to have considered the issue, prior to the court of appeals' decision in this case, was (and is) that non-fiduciary parties in interest *are* subject to actions for equitable restitution under § 502(a)(3). *See* Pet. 9-10. Despite these rules, none of the dire consequences predicted by Respondents and their *amici* has come to pass. To the contrary, pension plans have abundant investment opportunities, and hold "an estimated 20% of all outstanding stocks and 17% of all outstanding bonds." BMA Br. 11.[15]

Respondents and their *amici* warn (Resp. Br. 42-43; BMA Br. 13-15) that many of the exemptions to ERISA's prohibited transaction provisions are technical and dependent on information beyond the knowledge of non-fiduciary parties in interest. Again, both fiduciaries and non-fiduciary parties in interest are *already* required to cope with these problems to avoid liability for prohibited transaction penalties and excise taxes. For example, because of the broad definitions of party in interest and disqualified person, *see* ERISA § 3(14); 26 U.S.C. § 4975(e)(2), it can be difficult for a fiduciary to determine whether another party is a party in interest or disqualified person. Similarly, the application of prohibited transaction exemptions sometimes depends on information known to one party, but not the other.[16] In practice,

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[15] Respondents' complaint (Resp. Br. 44) that Petitioners' interpretation of § 502(a)(3) would allow a suit against "any person ... for some other person's violation of Title I" is greatly overstated. The text of § 502(a)(3) circumscribes itself by authorizing only "appropriate equitable relief" to "redress" a violation of Title I. Section 502(a)(3) does not subject non-fiduciaries to open-ended liability for damages, but instead is limited to equitable restitution in situations where a non-fiduciary would be unjustly enriched if allowed to retain plan assets and profits.

[16] *See, e.g.*, ERISA § 408(b)(1) and 26 U.S.C. § 4975(d)(1) (exemption for receipt of a loan by party in interest or disqualified person depends on information possessed by plan fiduciary); ERISA § 408(b)(5) and 26 U.S.C. § 4975(d)(5) (exemption for contracts with insurance companies depends on information possessed by party in interest or disqualified person).

fiduciaries and parties in interest navigate these provisions by requiring the parties with whom they deal to give appropriate representations, warranties, and indemnifications.[17]

4. Respondents suggest (Resp. Br. 41) that allowing a fiduciary to "shift liability" for § 406(a) violations to a party in interest "could dilute the force of the statutory proscription that a 'fiduciary ... shall not cause' a plan to engage" in prohibited transactions. That simply is not so. Whether or not a fiduciary brings suit under § 502(a)(3) seeking "appropriate equitable relief" from a party in interest, the fiduciary remains fully liable for its own violations – both in damages *and* in restitution – in suits brought by any plan participant or beneficiary or the Secretary of Labor pursuant to § 502(a)(2). The availability of attorneys fees under § 502(g) provides an additional incentive to bring such suits where they are warranted.

It is *Respondents'* position, not Petitioners', that has "unsettling consequences." Resp. Br. 42. If Respondents' position were adopted, non-fiduciary parties in interest that engage in prohibited transactions with tax-qualified plans would be shielded from civil liability under Title I of ERISA. That would mean, for example, that a non-fiduciary service-provider that sells worthless investments to a plan will be immune from Title I liability.

## IV. The Legislative History Of ERISA Is Consistent With The Statutory Language.

The court of appeals properly "hesitate[d] to give too much weight to legislative history." J.A. 353. As shown above, the language of § 502(a)(3) is unambiguous, and therefore the Court should decline Respondents' invitation to "resort to legislative history to cloud a statutory text that is clear." *Ratzlaf v. United*

[17] *See, e.g.*, Pension Plan Investments, *supra* note 13 at 23, 125-29. As for Respondents' complaints about the technical nature of the exemptions, sophisticated financial institutions (such as Respondents) and their counsel appear to be able to cope with them, *see generally id.*, and are required to do so in any event.



*States*, 510 U.S. 135, 147-48 (1994). In any event, the legislative history is consistent with the statutory text.

1. As the court of appeals recognized, the statement in the Conference Report that "the conference substitute prohibits plan fiduciaries *and parties-in-interest* from engaging in a number of specific transactions" "impl[ies] that *both* parties to the transaction would be liable." J.A. 352 (quoting H.R. Conf. Rep. No. 93-1280, at 306 (1974), 3 Leg. Hist. 4573)) (emphasis added). Respondents nevertheless focus on an unenacted provision of the Senate bill that would have expressly subjected parties in interest to liability for engaging in prohibited transactions. Resp. Br. 27-28.

The Senate provision would have made parties in interest "personally liable" for *damages*. *See* H.R. 2, 93d Cong. § 511, 3 Leg. Hist. 3780. As noted above, unlimited personal liability for direct and consequential damages is quite different from limited liability to make equitable restitution. The fact that a proposal to make parties in interest personally liable in damages was not ultimately enacted thus is not probative of the question whether parties in interest may be required to disgorge ill-gotten gains.[18]

2. In an effort to prop up their shaky argument from congressional inaction, Respondents resort to an even shakier argument based on a *divided* congressional *staff* recommendation. Resp. Br. 5-6, 28, 33). The staff recommendation does not represent the views of even a single elected member of Congress, was couched in the form of a suggestion (that the conferees "*may* wish to adopt the approach of the House bill and not provide civil liability for parties-in-interest"), and included a footnote (omitted from Respondents' brief) stating that "[n]ot all the staff agree with this suggestion." J.A. 282. If the Court wishes to consider recommendations, it should look to the recommendation of the

[18] Reliance on a so-called "rejected proposal" is particularly suspect where, as here, the proposal "rejected" is considerably different from the interpretive question at issue *See, e.g.*, *Monell v. Department of Soc. Servs.*, 436 U.S. 658, 664-65 (1978) (overruling *Monroe v. Pape*, 365 U.S. 167 (1961), based on *Monroe*'s inappropriate reliance on a rejected legislative proposal).

Executive Branch: "The Secretary of Labor should have authority to bring an action against parties in interest who participate in a prohibited transaction as well as against fiduciaries alleged to have breached their responsibilities under the Act." Administration Recommendations to the House and Senate Conferees on H.R. 2 To Provide Pension Reform at 9 (1974), 3 Leg. Hist. 5047, 5060.

3. Respondents' reliance on the "rejected" Senate proposal is further undermined by the fact that crucial language in the "catch-all" provision ultimately enacted as § 502(a)(3) originated in the *Senate* bill. *See* Pet. Br. 41-42. The House bill included a provision that authorized civil actions "by the Secretary, or by a participant, beneficiary, or fiduciary to enjoin any act or practice which violates any provision of this title." H.R. 2, 93d Cong. § 503(e)(3), 3 Leg. Hist. 4047. The House provision differs from the enacted version of § 502(a)(3) of ERISA in a critical respect: it does not include language authorizing "appropriate equitable relief" to "redress" any violation of Title I. That language was modeled on provisions in the Senate bill authorizing "appropriate relief, legal or equitable" and "such other relief as may be appropriate to effectuate the purposes of the Act." H.R. 2, 93d Cong. §§ 692, 693, 3 Leg. Hist. 3815-16.

The fact that several features of the Senate proposal were not ultimately enacted – namely, a provision expressly making parties in interest personally liable for damages as well as restitution (Senate bill § 511) and a provision expressly permitting suits "against any person who has ... received any assets of the plan" (Senate bill § 693) – is hardly fatal to Petitioners' argument. As Respondents acknowledge (Resp. Br. 28), the conferees compromised by adopting some of the features of the Senate proposal, including the Senate's provisions for excise taxes and civil penalties. The compromise also included the insertion of language into § 502(a)(3), drawn from the Senate bill, authorizing "appropriate equitable relief" to "redress" violations of ERISA.

4. Respondents also rely on statements that "[t]he labor law provisions [in Title I] apply rules and remedies similar to those under traditional trust law to govern the conduct of fiduciaries," while "[t]he tax law provisions [in Title II] apply an excise tax on disqualified persons." H.R. Conf. Rep. No. 93-1280, at 295



(1974), 3 Leg. Hist. 4562. The Conference Report states that "[t]his division corresponds to the basic difference in focus of the two departments." *Id.* These statements hardly provide an adequate basis for departing from the plain language of § 502(a)(3). Although the "focus" of the "labor law provisions" may be "rules and remedies under traditional trust law to govern the conduct of fiduciaries," that is not the *exclusive* focus of those provisions, as shown by § 502(i). Furthermore, applying the "traditional trust law" remedy of equitable restitution to undo a transaction caused by fiduciary misconduct falls within the "focus" of the labor provisions.[19]

## V. This Court's Decisions Do Not Support A Departure From The Statutory Text.

In *Mertens v. Hewitt Associates*, 508 U.S. 248 (1993), the Court observed that, while no provision of ERISA explicitly requires a non-fiduciary to avoid participation in a fiduciary's breach of fiduciary duty under § 409, ERISA "contains various provisions that can be read as imposing obligations upon nonfiduciaries." *Id.* at 253-54. Respondents suggest (Resp. Br. 36) that the "provisions" to which this Court was referring are § 502(i) and § 4975. But that is not what the Court said. To the contrary, the Court cited § 406(a) as an "example" of a "provision[] that can be read as imposing obligations upon nonfiduciaries." *Mertens*, 508 U.S. at 253-54 & n.4. Under § 406(a), the Court noted, "a person who provides services to a plan is a 'party in interest' ... and may not ... engage in certain other transactions with the plan ...." *Id.*

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[19] In amending ERISA in 1989 to add § 502(*l*), the conferees stated:

> [T]he need for strengthened enforcement and deterrence of violations of ERISA applies not only to the Department of Labor, but to judicial oversight of private rights of action affecting employee benefit plans. It remains the intent of Congress that the courts use their power to fashion legal and equitable remedies that not only protect participants and beneficiaries but deter violations of the law as well.

H.R. Conf. Rep. No. 101-386, at 432-33 (1989).

The distinction this Court suggested in *Mertens* between participation-in-fiduciary-breach claims and prohibited-transaction claims is valid.[20] As Petitioners have explained (Pet. Br. 46), the fiduciary-duty provisions at issue in *Mertens* differ from § 406 in an important respect: whereas there are no necessary counter-parties to a fiduciary breach, a party-in-interest *is* a necessary counter-party to a transaction between a plan and a party in interest.[21] Even if the Court were to conclude that an "explicit[]" congressional statement providing for non-fiduciary liability is necessary in the absence of *any* provision that requires a non-fiduciary to avoid participating in a fiduciary breach, it would not follow that such a statement is necessary where the non-fiduciary is, by definition, an essential party to the prohibited transaction (and is explicitly subject to punitive excise taxes and civil penalties for participating in the transaction).[22]

The Court's decision in *Central Bank v. First Interstate Bank*, 511 U.S. 164 (1994), concerns § 10(b) of the Securities Exchange Act of 1934, not ERISA. Moreover, the basic principle reaffirmed in *Central Bank* – that "the text of the statute controls" the liability inquiry, *id.* at 173 – supports Petitioners' interpretation of

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[20] *See also Nieto v. Ecker*, 845 F.2d 868 (9th Cir. 1988) (in which Judge Kozinski's opinion for the court adopted the same distinction by refusing to recognize a party in interest's liability under § 409 for "knowing participation," but recognizing its liability under § 406(a) and allowing suit under § 502(a)(3) for equitable relief).

[21] Respondents observe that a party in interest is not a necessary counter-party to every type of transaction prohibited by § 406. That is true, but irrelevant to the appropriate treatment of prohibited transactions, like those at issue here, that *do* necessarily involve a party in interest.

[22] *Lockheed Corp. v. Spink*, 517 U.S. 882, 889 n.3 (1996), expressly reserved the question presented in this case. *Lockheed* held that there is no violation of § 406(a) unless a fiduciary causes the plan to engage in a prohibited transaction; this case has been litigated on the assumption that the plans' investment manager (a fiduciary) caused the plans to enter into prohibited transactions. *See* Pet. Br. 47-48. *Peacock v. Thomas*, 516 U.S. 349 (1996), also cited by Respondents, involved "no violation of ERISA or of the plan." *Id.* at 353.



§ 502(a)(3). Were the Court to look for securities-law analogues to this case, a far more appropriate comparison would be to *Dirks v. SEC*, 463 U.S. 646 (1983). In *Dirks*, the Court held that a "tippee" acquires a "duty" under § 10(b) to abstain from trading on inside information when "the insider has breached his fiduciary duty to shareholders" by disclosing information to the tippee and "the tippee knows or should know that there has been a breach." *Id.* at 660. Notably, the Court cited trust-law principles to explain the tippee's duty: A "third person [who] ... had notice of the [fiduciary's] violation of duty, holds upon a constructive trust for the beneficiary any profit which he makes through the use of such information." *Id.* at 661 n.20 (quoting 3 L. Loss, *Securities Regulation* 1451 (2d ed. 1961)). Salomon, as a party in interest who has reaped a $20 million windfall by virtue of its participation in a prohibited transaction, stands in the same position as the hypothetical tippee in *Dirks*, and thus has a duty to pay restitution.

## VI. Salomon's "Independent Ground" For Affirmance Is Illusory.

Tacked onto Respondents' brief as an asserted "independent ground" for affirmance is an argument that, assuming non-fiduciary parties in interest may be sued for restitution under § 502(a)(3) to remedy a violation of § 406(a), Petitioners have not adduced evidence that Respondents "knew" that any fiduciary was violating § 406(a). Resp. Br. 47. The court of appeals did not consider this argument, and this Court need not do so either. In the very case cited by Respondents, the Court "decline[d] to decide" a "scienter" issue not reached by the court of appeals. *United States v. X-Citement Video, Inc.*, 513 U.S. 64, 79 (1994).

As a *legal* matter, Respondents' assertion that a party in interest's *actual* knowledge of the fiduciary's violation "must be an element" of an action under § 502(a)(3) is unfounded. In support of their assertion, Respondents resurrect the straw man of "strict liability." As Petitioners have shown, *see supra* pages 8-9 n.9, 10-11, the common law of restitution generally imposes a "knows or

should know" standard on parties in possession of trust assets obtained through a breach of trust.[23]

As a *factual* matter, the district court – the only court to have considered the issue – held that there is sufficient evidence in the record to support the conclusion that Respondents satisfied a constructive knowledge requirement. *See* J.A. 311; *see also* Pet. Reply Br. 6; C.A. Supp. App. 95-104, 108-09, 250, 381-84. This is not the appropriate forum for review of that factual determination.

**Conclusion**

The judgment of the court of appeals should be reversed.

Respectfully submitted,

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[23] Respondents' reliance on the "knowing participation" standard applicable to co-fiduciaries under § 405(a) is likewise misplaced. Sections 409 and 502(a)(2) make fiduciaries "personally liable" in *damages* for knowingly participating in another fiduciary's breach. It does not follow that the same knowledge requirement applies to the far more limited remedy of *equitable restitution*.